Select Committee on the Operation of the Capital Gains Tax Discount
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Submission to: Select Committee on the Operation of the Capital Gains Tax Discount: December 2025

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The Tax and Transfer Policy Institute (TTPI) welcomes the invitation to make a submission to the Select Committee on the operation of the Capital Gains Tax Discount, as the discount forms an important component of the Australian income tax system as a part of the broader regime for the taxation of savings and returns to capital in Australia.

TTPI was established to undertake independent policy research relevant to the Australian tax and transfer system, to foster informed public debate and to raise awareness of tax and transfer policy issues. Of relevance to the select committee, our Taxation of Savings Report[1], examined how Australia does, and should, tax assets and the flow of income from assets, including considering how the Capital Gains Tax Discount and other policies shape incentives for individual savers.

That report ultimately recommended a much-needed overhaul of the taxation of savings under which most savings would be taxed at a single low, flat rate separate to taxes on labour income. This design would not distort decisions between savings vehicles. Such a move may be beyond the terms of reference of the committee, but any incremental reform to the taxation of capital gains should still be made with a view to delivering greater allocative efficiency and fairness to the tax system by bringing the taxation of different savings vehicles into closer harmony.

This submission does not make an explicit recommendation regarding the design of the CGT discount. Rather, it aims to clarify the underlying rationale for the discount, as well as identifying the trade-offs involved in different policy options.

Why do we have a Capital Gains Tax Discount?

There are strong, conceptual reasons that income from savings should be taxed at a rate lower than labour income. The two main arguments are that:

- Savings taxes reduce the incentive to save, and the distortive impact of these taxes compounds in a similar manner to compound interest.[2]
- Savings taxes are levied on the nominal return to savings, which can result in a very high tax rate on the real returns to savings.

[1] Varela, P., R. Breunig and K. Sobeck (2020). "The taxation of savings in Australia: Theory, current practice and future policy directions", Tax and Transfer Policy Institute Policy Report 01-2020.
[2] Chamley, C. (1986). "Optimal taxation of capital income in general equilibrium with infinite lives." Econometrica 54(3): 607–622. Judd, K. L. (1985), "Redistributive taxation in a simple perfect foresight model", Journal of Public Economics, 28/1, pp. 59–83.

With regard to capital gains, there is an additional concern that high tax rates may create a 'lock-in' effect in which investors avoid turning over assets as this would trigger a capital gains event. The magnitude of this effect on asset turnover is broadly comparable to that of stamp duties.[3]

There are also downsides to taxing capital gains at a lower rate. A large gap between the tax rate on capital gains and labour income creates an incentive to reclassify labour income as capital gains income. It also places a greater tax burden on labour income and increases inequality.

The CGT discount represents a policy trade-off across all of these dimensions.

Investment properties are currently taxed more heavily than other types of investments

The Select Committee's terms of reference paragraphs (a) – (c) all refer to the effect of the CGT discount on portfolio allocation, and particularly the effects of the policy on demand for housing assets. A relevant initial question is whether the existing capital gains treatment results in a lower tax of investment properties compared to other types of household investment.

We approach this question in our policy report on savings taxes[4] and find that, even with the tax benefits of negative gearing, a typical investment property is taxed much more heavily than owner-occupied property and superannuation. This result occurs because stamp duty and land taxes paid on investment properties are larger than the tax benefits of negative gearing. However, at higher taxable income levels, negatively geared properties are taxed at rates comparable to those applying to domestic shares, and lower than those rates applying to international shares or domestic savings accounts.

Increasing taxes on savings and reducing labour taxes would improve intergenerational equity

In a recent working paper,[5] the TTPI examines trends in the income of Australians at different ages, along with the role that the Australian tax and transfer system plays in addressing intergenerational equity. In this paper, we concluded that the Australian tax and transfer system has not adjusted to the changing age profile of income in Australia and that the tax and transfer system. As a result, current settings increasingly favour older Australians at the expense of younger Australians.

There are several ways to address this balance, including reducing taxes on labour income, increasing taxes on income from savings, and improving the means testing of payments to older Australians. Reducing the CGT discount would represent a small step towards restoring intergenerational balance in the tax and transfer system.

Why is there a 50 percent discount?

As other submissions have noted, the current CGT discount of 50 per cent for individuals was introduced in 2000 in response to a recommendation from the Business Taxation Report[6] (Ralph review). Prior to that, capital gains for assets acquired after 1985 were assessed based on an

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[3] Varela, Breunig and Sobeck (n 1) 25
[4] Ibid. Figure 1.
[5] Varela, P. Breunig, R. and Smith, M. "Measuring the changing size of intergenerational transfers in the Australian tax and transfer system", TTPI - Working Paper 7/2025.
[6] Known as the Ralph Review. Ralph, J. (1999), "Review of business taxation: A tax system redesigned", Report to the Australian Government.

uplifted indexation to the capital cost base, to abstract the effect of changing prices from the real return on capital which genuinely increased an individual's consumption possibilities.

The Ralph review explicitly linked the CGT discount to an adjustment for inflation but also sought to incentivise investment in Australian equities through a lower rate. Although at the time the review received many submissions in support of retaining indexation arrangements, such provisions are fairly rare, internationally. The OECD identifies only three jurisdictions (Chile, Mexico and Israel) where an explicit adjustment is made for inflation on capital gains, even though "explicit inflation adjustment compensates individuals for the inflationary component of gains more directly and accurately than broad tax provisions."[7]

Is a 50 percent discount too generous?

In the period since this change, inflation has averaged less than the real rate of return (due to the success of Reserve Bank inflation targeting), meaning that the current CGT discount represents a lower tax rate on capital gains than would apply (on average) if an indexation system had been retained with no discount. Therefore, a modest reduction in the CGT discount would better align with the notional goal of taxing the real investment return. A 40% discount rate was recommended in Australia's Future Tax System Review[8], though that was in the context of a recommendation to extend this discount to other forms of savings, such as bank interest, to create a more neutral taxation treatment of savings.

Again, however, the CGT discount represents a multi-dimensional policy trade-off, meaning that there is no 'correct' CGT tax rate. Instead, a decision to reduce the CGT discount would:

- Increase the tax rate on household savings, making it harder for households to smooth consumption across their lifetime.
- Increase the likelihood of capital gains 'lock-in'.
- Increase the gap in the tax rates on capital gains and the two largest household investments (superannuation and owner-occupied housing), while decreasing the gap between negatively geared property and other taxable savings vehicles.
- Reduce the incentive to reclassify labour income as capital gains.
- Shift the tax mix towards savings income and away from labour income, which improves the intergenerational balance of the tax system.

Were there to be a move to lower the CGT discount, it would be important to consider whether or not to grandfather existing provisions. In our view, any change should be applied to everyone, immediately, with no grandfathering. This would avoid large lock-in effects that grandfathering would likely generate.

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[7] Hourani, D. and S. Perret (2025), "Taxing capital gains: Country experiences and challenges", *OECD Taxation Working Papers*, No. 72, OECD Publishing, Paris.
[8] Commonwealth of Australia (2010), "Australia's future tax system review" (The Henry Tax Review), Australian Government, Canberra.